Central Bank macro prudential rules submission

Impact of Central Bank rules on the property market: Quantitative analysis
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The Central Bank has called for "evidence-based" submissions to inform its review of macro-prudential rules first introduced at the beginning of 2015. In this spirit, a diverse group of property interests has set aside their competitive instincts to collaborate in this unique survey of existing homeowners and prospective buyers. The survey is the first of its kind and provides an informative insight into buyer's opinions on savings, affordability, the rental market and, most notably, the macro prudential rules and their impact.

The primary aim of this commentary is to give an independent view of the results and to put the responses in a wider economic context. The Central Bank's objective is to "*increase the resilience of the banking and household sectors to shocks in the property market*" and to reduce the risk of a repeat of the crisis that Ireland endured in the late 2000s. All stakeholders will have an opinion on the rules, but this is the first time that the views of the users of credit for house purchase have been compiled in a systematic way. The results contain some interesting findings and can be divided under a number of headings:

1. **Awareness of Central Bank rules is high**

Gone are the financially uninformed days of the "I don't know what a tracker mortgage is" generation. Instead, the vast majority (81%) of respondents are acutely aware of the Central Bank rules. This can be partly explained by the fact the respondents to the survey are interested in purchasing a home; indeed, 99% of the respondents stated that they were either in the process of buying a home, currently saving for a home or interested in purchasing a home. The survey, therefore, may not be representative of awareness in the population at large, but this cohort's views are arguably more important for the purposes of a review of the Central Bank macro prudential rules.

2. **Buyers believe Central Bank rules will make it more difficult to buy**

A majority of both first-time buyers (FTBs) and non-first-time buyers believe that the Central Bank rules will make it more difficult to purchase a home. Importantly, the wording of this particular question referenced the deposit rules specifically rather than the income limits.

In the case of first-time buyers, 71% stated that the rules would have an impact, with 77% of this group stating that the impact would be negative. Almost a quarter (23%) of those stating that the rules would have an impact believed it would be positive. This possibly reflects a view that the rules would reduce demand overall, thus decreasing competition for a limited supply of properties.

For non-FTBs, the proportion (71%) believing that the rules would have an impact is exactly the same as FTBs, but a higher proportion (89%) of these believe that it will make it more difficult to purchase a home. This may reflect the higher deposit requirements for non-FTBs relative to FTBs.

For those saving to buy, the Central Bank LTV rules have resulted in a delay in purchasing, as reported by respondents, with 69% agreeing that "having to save a higher amount of money means that buying has to be "put on the long finger". This proportion rises to 73% for FTBs. A key knock-on consequence of this view is increased demand in the rental sector, a market where there is also limited supply, thus contributing to the ongoing rental price growth. Affordability issues are now very prevalent in the rental sector as a result, with rents already 6% above their previous peak (CSO).

3. High prices & deposits are the main inhibiting factors to purchase

There are two separate questions on the inhibiting factors to purchasing a home contained in the survey. The first asks all of the respondents what the factors that may inhibit house purchase are. The second focuses on those who believe that the Central Bank rules will make buying more difficult.

Starting with the full sample, 46% cite deposit-related reasons as an inhibiting factor, while 42% state "high prices". For FTBs, these proportions are significantly higher, with 64% citing deposits and 53% citing high prices.

The survey goes on to pinpoint the *main* inhibiting factor among a range of responses. High prices come out on top here, with 36% of the total sample citing this reason. Deposit-related factors are believed to be the main inhibiting factor for 30% of respondents. For FTBs, the proportion rises to 45% and 35% respectively for these two issues.

Delving deeper into those who state that deposits are the main inhibiting factor, a significant proportion (12%) simply state that they "don't have the money for a deposit", which may be simply a timing issue. However, 6% state that their rent is too high to save for a deposit while a further 11% state that they are unable to save a deposit. A much higher proportion (13%) of FTBs state that their rent is too high to save for a deposit.

For those who have stated that the Central Bank rules will make it more difficult for them to buy, deposit-gathering is, by far, the most cited reason. 49% of FTBs believe that the deposit requirement is too high, with 20% stating that it was hard to rent and save and 13% stating that it was "hard to save". Although the sample sizes are small, those wanting to buy above the €220,000 level are more likely to cite high deposit requirements as a barrier to entering the market. Only 12% of FTBs referred to loan limit factors in this response.

The top reasons cited by non-FTBs are relatively similar. 43% believe that the deposit requirement is too high, with 35% also saying that it is difficult to save or raise a deposit. 16% mention the cost of living. This is substantially more prominent than FTBs, undoubtedly reflecting the cost of childcare, for example. Somewhat surprisingly, only 10% state that negative equity is an issue.

4. Savings process taking four years on average for first-time buyers

Given the prominence of deposit-related issues in the responses, it is important to delve into this issue further. The survey provides us with the evidence to do exactly that. For those FTBs who have started saving, these have been doing so for an average of 2.1 years already. Asked how long more they would need to save for, the average response was a further 2.1 years. We can say, therefore that the average savings period for FTBs is now estimated to be four years.

5. Resorting to the bank of Mam and Dad

On its own, this result does not appear overly surprising, but what is the source of the saving? Among the savers in the sample, there is an average of 1.4 methods used. The most common method was savings was by way of a bank account (74%), followed by credit union savings (24%). Almost one in three savers are relying on family members for either a gift (24%) or a loan (7%) for a deposit. 37% of FTBs rely on a family contribution in saving for a deposit. Importantly, those who believed the Central Bank rules would make it more difficult to purchase were more likely to rely on a family contribution for a deposit.

6. Protecting people from themselves

Protecting against over indebtedness is one of the laudable goals of the Central Bank's macro prudential rules. Left unchecked, personal debt may rise to unsustainable levels. A key result of the survey – and a concerning one – is that 55% of borrowers are likely to consider trying to borrow more if the rules were to be relaxed. Of course it does not follow that lenders would necessarily facilitate them. There are two potential interpretations of this result. The first is that the buyer can afford the higher ongoing payments associated with a higher LTV mortgage or that the borrower would like a larger mortgage based on their current income. The latter implicitly assumes that the borrower would put a larger proportion of their income towards the payment of their mortgage. The former would indicate that the deposit, rather than the ongoing payment, is the more binding constraint. Setting maximum loan to income limits is sensible, with the level of these limits a matter of interpretation based on the interest rate, term and tax regime.

Conclusion

The results of the survey are relevant to housing policy beyond simply the macro prudential rules. It is telling that even though prices are 35% below peak levels, over a third believe that prices remain too high. Clearly, the response to this issue should not be to simply increase the amount of money that people are allowed to borrow. Wider government efforts are already underway in an attempt to bring down the cost of supplying new residential properties. This, however, will be a slow process.

In the meantime, the survey responses suggest that deposits are the primary inhibiting factor outside of high prices. This factor is thus leading to a situation of reliance on family support. Therefore, the rules are contributing to an inequality of opportunity between those with family wealth and those without. It is also leading to an urban sprawl as buyers move further from their desired location

Macro prudential rules are a welcome new additional to the Central Bank's tool kit in Ireland. However, housing policy cannot be seen in isolation. There needs to be a recognition of the consequences of policy decisions on the wider market.

Any changes to the rules must respect the original intention of the rules while recognising the unintended consequences. There is not a clear conclusion of the loan-to-income rules in this survey of potential buyers, but the loan-to-value restrictions, which are primarily designed to protect banks rather than users of credit, are having clear negative knock on implications in the areas of equity, rental affordability and urban sprawl.